ST 01-15
Tax Type: Sales Tax
Issue: Books and Records Insufficient

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

THE DEPARTMENT OF REVENUE	**)**		
OF THE STATE OF ILLINOIS	**)**	**Docket #**	**97-ST-0000**
v.	**)**	**IBT #**	**0000-0000**
ABC BANK	**)**		
Taxpayer	**)**		
	)		
THE DEPARTMENT OF REVENUE	**)**	**Docket #**	**97-ST-0000**
OF THE STATE OF ILLINOIS	**)**	**IBT #**	**0000-0000**
v.	**)**		
XYZ CORP.	**)**	**Barbara S. Rowe**	
Taxpayer	**)**	**Administrative Law Judge**	

RECOMMENDATION FOR DISPOSITION

Appearances: McNamara & Evans, by Mr. Edward D. McNamara, Jr., for ABC BANK and XYZ Corporation; Mr. Charles Hickman, Special Assistant Attorney General, for the Illinois Department of Revenue.

Synopsis:

This matter arose on the timely protest of ABC BANK and XYZ Corporation's (hereinafter collectively referred to as the "Taxpayers") to Audit Corrections and/or Determinations of tax due issued by the Illinois Department of Revenue (hereinafter referred to as the "Department") for use taxes due on trucks, trailers, and repair parts for those vehicles. The issues in this case are:

1. Were the trucks, trailers, and parts at issue used in interstate commerce for-hire when XYZ Corporation (hereinafter referred to as "XYZ") hauled products for Concrete Company and the documentation showed that XYZ was the entity that the product was sold to?

2. Prior to the statutory change in 1999, was the Department correct in asserting that the taxpayers should use the trucks, trailers, and affiliated parts at issue in a "regular and frequent" manner to qualify for the rolling stock exemption?

3. Was it appropriate to use the six-year statute of limitations for the audit of XYZ concerning the repair parts and tires at issue and the three-year statute of limitations regarding the purchase of trucks and trailers?

Following the submission of all evidence and a review of the record, it is recommended, with regard to the assessments against XYZ, that this matter be resolved partly in favor of the Department of Revenue, with adjustments. It is also recommended that this matter be resolved partly in favor of XYZ, with adjustments. It is recommended that the liability of ABC BANK be upheld with an adjustment for the three trucks determined to be exempt under the 15-trips per 12-month standard. It is also recommended that the penalties at issue be abated.

FINDINGS OF FACT:

1. The *prima facie* case of the Department inclusive of all jurisdictional elements was established by the admission into evidence of Department's Exhibits 1 through 3. (Tr. p. 106[1])

2. The Department issued an Audit Correction and/or Determination of Tax Due to ABC BANK (hereinafter referred to as "ABC's") for penalties and tax for the period of May 1, 1994 through August 31, 1994, in the amount of $28,329.00. (Dept. Ex. No. 2)

3. The Department performed a limited scope field sales tax audit on ABC's. The audit was in relation to five trucks purchased by ABC's and leased to XYZ, who operated them. (Dept. Ex. No. 13; Tr. pp. 7, 14)

[1] The hearing in this matter lasted over a period of three days. The pages of the three transcripts are consecutive; therefore, only the page number of the transcripts will be used.

4. The Department has agreed that three of the five trucks at issue that are owned by ABC's and leased to XYZ qualify for exemption under the 15-trips per 12-month standard. (1st Memorandum of the Department)

5. The Department issued an Audit Correction and/or Determination of Tax Due, form SC10, to XYZ for penalties and tax for the period of January 1, 1990 through September 30, 1995, in the amount of $105,861.00. This was the first audit of XYZ that was performed by the Department in relation to this matter. (Dept. Ex. No. 1)

6. The tax and penalties that the Department proposes against XYZ for the first audit are attributable to the purchase of 19 trucks, trailers, or parts and tires for those vehicles for which the taxpayer claimed the rolling stock exemption under the Use Tax Act. (Dept. Ex. No. 5; Tr. pp. 9-11)

7. XYZ was not registered with the Department for Retailers' Occupation or Use Tax purposes prior to the initial audit. Because there were no monthly returns filed by XYZ for the purchases of repair parts and tires for the trucks, the Department determined that the statute of limitations extended back to January 1990. Because returns were filed for the trucks and trailers, the Department determined that the statute of limitations for those items was three years, extending from January 1993 through the end of the initial audit period or September 1995. (Tr. pp. 10-13, 53-59)

8. A deficiency is assessed against a taxpayer when a return is filed but the tax is not paid in full. A delinquency is assessed when a return is not filed. Different penalties are assessed against a delinquency and a deficiency. Both deficiencies and delinquencies were assessed against XYZ. (Tr. pp. 8-17)

9. For the initial audit of XYZ, the auditor performed an analysis with regard to the trucks that were purchased during the period of January 1993 through December 1995 and whether they qualified for the rolling stock exemption. The analysis was done only on trucks purchased during that time period. The analysis compared the total days the truck was operated

during that period with the days it was used in interstate commerce. (Dept. Ex. Nos. 9-11; Tr. pp. 25-39)

10. The first auditor went through two primary accounts for XYZ: 1) trucks 2) truck parts and tires. He listed all of the purchases for truck parts and tires for 1994 and then went through the invoices to verify whether tax was paid. He consulted with XYZ to see if it wanted other years to be considered in the sampling but no further records were provided. The auditor made a written request to XYZ for agreement with the sampling that the taxpayer refused to sign. (Dept. Ex. No. 6; Tr. pp. 17-19, 58, 64, 81, 98-99)

11. The first auditor for the Department determined an error percentage for 1994 and applied it to the population base in the rest of the first audit period to arrive at the figures due for tax purposes. (Tr. pp. 19-21, 60-61)

12. The first auditor for the Department also analyzed the trailers at issue. He was unable to determine whether the trailers were used for interstate commerce by the records that XYZ provided. The invoices provided did not reflect the mileage of the trips taken by the trailers. Therefore, the auditor did two types of analysis, one based upon days the trailers were used and another based upon miles traveled. The auditor calculated the miles using a map. If the auditor had evidence of multiple trips taken in the same day, he noted it. (Tr. pp. 27,66-67, 82)

13. XYZ has a sister company named Concrete Company (hereinafter referred to as "Concrete"). XYZ shares its principal place of business in Anywhere, Illinois, with Concrete. Concrete is a cement ready-mix company for which XYZ hauls rock and cement. The bills of lading reflect that XYZ was the purchaser of the product. The invoices were billed to XYZ and XYZ paid for the product. There is no invoicing from XYZ to Concrete; rather, bookkeeping entries reflected the sales. There was no separation of the charges for the materials and the hauling. There were no invoices available regarding carriage engaged in by XYZ for Concrete. (Tr. pp. 41-44, 81-82)

14. The Vice-President and office manager of XYZ is also the office manager of Concrete. Concrete had facilities located in several locations in Illinois. (Taxpayer's Ex. No. 18; Tr. pp. 256-257, 278)

15. From the bookkeeping records available, the auditor determined that XYZ was the purchaser of products that were resold to Concrete. Based on the books, records, and invoices provided, the Department determined that XYZ purchased the products, paid for it, and then resold the product to Concrete. Invoices, bills of lading, check payment stubs, purchase and sales records of both XYZ and Concrete indicate that XYZ was the purchaser of the products. The only documentation of the sales from XYZ to Concrete are bookkeeping entries. There is no separation of the amount charged for the product and the amount for carriage. (Tr. pp. 41-44, 81-84)

16. In the analysis for the rolling stock exemption, the auditor did not take into account the number of trips XYZ took for delivery of materials to Concrete, as he determined that the documents provided showed that XYZ was hauling its own product. (Tr. pp. 44-45, 67-76, 101)

17. XYZ at the time of the hearing employed 40 personnel. Aside from two clerical staff, the other 38 employees were truck drivers. The cost and value of the assets of the company had been devoted to trucking equipment. (Tr. pp. 258-259)

18. On August 15, 1989, XYZ was issued permit No. 00 000000 from the Interstate Commerce Commission as evidence of the carrier's authority to engage in interstate transportation as a contract carrier by motor vehicle. The authority was in effect during all of the audit periods in question. The authority is effective as long as the carrier maintains compliance with various CFR regulations. The authority has to do with shipments other than grain. (Taxpayer Ex. No. 5; Tr. pp. 259-260)

19. On November 24, 1982, XYZ was issued a registration by the Illinois Commerce Commission as an Exempt Interstate Carrier pursuant to identification No. 00000 00-0 under file No. 00000000. The Exempt Interstate Carrier Registration has to do with the grain shipments of XYZ. (Taxpayer's Ex. No. 6; Tr. pp. 260-261)

20. XYZ is also authorized to act as a for-hire trucking operation for intrastate movements in Illinois pursuant to its public carrier certificate issued on January 1, 1995.[2] (Taxpayer's Ex. No. 19; Tr. pp. 308-309)

21. The Department issued an Audit Correction and/or Determination of Tax Due to XYZ for penalties and tax for the period of October 1, 1995 through December 31, 1997, in the amount of $90,372.00. This was the second audit of XYZ that was performed by the Department in relation to this matter. (Dept. Ex. No. 3)

22. The second auditor for the Department performed no sampling, but rather looked at every transaction in detail for the audit period of October 1, 1995 through December 31, 1997. (Dept. Ex. Nos. 14 & 15; Tr. pp. 110-112)

23. Regarding the second audit of XYZ, the auditor discounted interstate mileage when XYZ hauled its own products; that is, where the bills of lading show that the product was sold to XYZ. (Taxpayer's Ex. No. 2; Tr. pp. 226-228)

24. The second auditor did not perform any analysis on XYZ's grain hauling activities based upon the opinion that the grain hauling was not a significant part of the business of XYZ. (Tr. pp. 158-159)

25. In compliance with the Illinois Commerce Commission and other regulatory bodies, XYZ had on file and maintained insurance for both liability and cargo. If XYZ was hauling cargo to a customer's location, and XYZ dumped that cargo, the customer would have to file a claim under XYZ's policy. (Taxpayer's Ex. No. 7; Tr. pp. 262, 319)

26. The global taxable exceptions found in the second audit were broken down into four categories: 1) taxable purchases of capital asset additions; 2) taxable purchases of consumable supplies-detailed-truck numbers known; 3) taxable purchases of materials used on repairs by outside servicemen; and 4) taxable purchases of consumable supplies-truck numbers unknown. (Dept. Ex. Nos. 14, 15; Tr. pp. 112-114)

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[2] Prior to 1995, XYZ had a Certificate of Public Convenience and Necessity from the Illinois Commerce Commission that was later replaced by the document marked as Taxpayer's Ex. No. 19. (Tr. p. 310)

27. The second auditor analyzed the trucks owned and used by XYZ during the audit period. Of those 37[3] trucks, only 15 showed interstate mileage. Driver's logs were used to get total mileage. A driver's log records where the driver is going, what he is doing, and the mileage. The auditor developed a percentage of rolling stock mileage compared to total mileage of each of the trucks. Rolling stock miles are interstate miles. (Dept. Ex. No. 16; Tr. pp. 114-115, 233)

28. The second auditor further examined the 15 trucks showing interstate mileage on a month-to-month basis. The bills of lading and trip sheets were examined and if XYZ was hauling its own product, the rolling stock trip was not allowed. The auditor determined that none of XYZ's vehicles acquired during the second audit time period prior to 1997 qualified for the rolling stock exemption. (Dept. Ex. No. 17; Taxpayer Ex. No. 2; Tr. pp. 118-122)

29. In the analysis of the repair parts, the second auditor used the number of days that a truck was used in interstate commerce for-hire to arrive at the allocation of parts that would qualify for the rolling stock exemption. (Tr. p. 235)

30. For the second audit of XYZ, the auditor examined XYZ's general ledger, which contained an inventory account. When XYZ purchased materials, the purchase was reflected in the inventory account. When XYZ sold the material, the inventory account was decreased. XYZ reflected one price for the sale of the inventory. The cost of hauling the inventory was included in the sale price. XYZ sold inventory to Concrete and other customers. (Tr. pp. 154-155)

31. The second auditor did an analysis of the sales of XYZ to Concrete versus other customers for 1995, 1996 and 1997. In 1995, 75% of XYZ's sales were to Concrete, in 1996 - 91% and in 1997 - 91%. (Dept. Ex. No. 22; Tr. pp. 155-156)

32. Through the general ledger, the second auditor discerned that XYZ began breaking out some hauling charges in April 1996. There were no invoices for the sales to

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[3] The auditor testified that there were 32 trucks, which is supported by Department's Ex. No. 19. However, 37 truck numbers were listed on Dept. Ex. No. 16. The discrepancy is clarified when the numbers are compared and five of the truck numbers were deleted from the analysis because they had no rolling stock miles as shown from the driver's logs. Examples of the trucks deleted were two Agracat stone spreaders (used to spread stone) and a super stone spreader. (Tr. pp. 162-164)

Concrete; rather, journal entries in the books reflect those sales. (Dept. Ex. No. 22; Tr. pp. 156-158)

33. In 1997 XYZ changed its method of doing business and no longer bought the materials. XYZ became a hauler of the products for its customers. The bills of lading, sales and purchase invoices, as well as check stubs reflect the change in procedure. The vendors' bills of lading indicate that XYZ's customers are the purchasers. From early 1997 forward, the auditor determined that trips made across state lines qualified in the analysis for the rolling stock exemption when XYZ operated in interstate commerce as a carrier for-hire. After XYZ changed its method of operations and bookkeeping, an invoice would reflect nothing but freight charges. The weigh tickets reflected the amount and product sold to the purchaser. Once the change in the method of operations occurred, the suppliers invoiced Concrete or XYZ's other customers for the materials that XYZ was hauling, and the customer wrote a check to the supplier. (Taxpayer's Ex. Nos. 4, 22; Tr. pp. 123-124, 148, 158, 203-204, 239-240, 266-268, 315-318, 323-329)

34. The Department's auditors used a "regular and frequent" standard to determine how a vehicle must be operated as an interstate carrier for-hire in order to qualify for the rolling stock exemption. (Tr. pp. 17, 124)

35. XYZ acquired 12 new trucks during the second audit period. XYZ would number its trucks within the fleet. Of those 12 new trucks, the second auditor determined that one qualified for the rolling stock exemption in 1997 because it was used for-hire on a regular and frequent basis in interstate commerce. Additionally, the repair parts for four other trucks also qualified for the exemption. One truck purchased in 1996 did not qualify for the exemption when purchased; however, once XYZ changed its method of operations in 1997, the repair parts and tires for that vehicle qualified for exemption. (Dept. Ex. Nos. 16-19; Tr. pp. 111-154)

36. The second auditor separated the repair and replacement parts for truck numbers known and truck numbers unknown. If the truck number was known and it qualified for exemption, the auditor exempted the repair/replacement part. For the parts where the truck number was unknown, the auditor added up all the purchases for unknown trucks and trailers for

1997 and multiplied that number by 80% which was the percentage of mileage that did not qualify for the rolling stock exemption. XYZ had a total of 32 trucks and trailers in use in 1997. Of those 32 trucks and trailers, six units qualified for the rolling stock exemption for that year. This means that 81.25% of XYZ's fleet for 1997 did not qualify for exemption for that period. The auditor did two types of analysis; the percentage of trucks that did not qualify versus the percentage of mileage that did not qualify, and used the 80% figure from the percentage of mileage. The 80% figure was more favorable for XYZ. The total figure for the allowed non-taxable purchases of repair and replacement parts was then subtracted from the auditor's list of global taxable exceptions. (Dept. Ex. Nos. 15, 20; Tr. pp. 149-152, 160-162)

37. XYZ did not provide the second auditor with documentation showing which trailers were used with which trucks although that information was requested. Regarding the repair and replacement parts for trucks whose numbers were known, if the truck was found to be exempt, the replacement part was also exempt. For the additional repair and replacement parts for trailers where the trailer numbers were known, the auditor again used the 80% figure discussed above to find the taxable portion of the 1997 purchases. (Dept. Ex. No. 21; Tr. pp. 152-154)

38. The Department concedes that two of the 19 trucks purchased by XYZ and included in the initial audit of XYZ qualify for exemption under the 15-trips per 12-month standard. The Department also concedes that an additional truck qualifies for exemption under that rule. (1st Memorandum of the Department; 2nd Memorandum of the Department)

39. The parties stipulate that the various pieces of tangible personal property for which the taxpayers are claiming the rolling stock exemption have, since their purchase, been utilized to some degree as rolling stock by an interstate carrier operating for-hire. (Tr. p. 103)

CONCLUSIONS OF LAW:

The Department prepared corrected returns which were admitted into evidence as Dept. Ex. Nos. 1 and 3 for Use Tax liabilities for XYZ Corporation pursuant to section 4 of the

Retailers' Occupation Tax Act, (hereinafter referred to as the "ROTA") 35 **ILCS** 120/4. The Department also prepared corrected returns (Dept. Ex. No. 2) for Use Tax liability for ABC BANK pursuant to section 4 of the ROTA (35 **ILCS** 120/4). Said section is incorporated into the Use Tax Act (hereinafter referred to as the "UTA") by §12 of the UTA (35 **ILCS** 105/12). Section 4 of the ROTA provides in pertinent part as follows:

> As soon as practicable after any return is filed, the Department shall examine such return and shall, if necessary, correct such return according to its best judgement and information, which return shall be prima facie correct and shall by prima facie evidence of the correctness of the amount of tax due, as shown therein.
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> Proof of such correction by the Department may be made at any hearing before the Department or in any legal proceeding by a reproduced copy ... in the name of the Director of Revenue. ... Such certified reproduced copy ... shall without further proof, be admitted into evidence before the Department or in any legal proceeding and shall by prima facie proof of the correctness of the amount of tax due, as shown therein.

In the case at issue, the taxpayers challenge the assessment by the Department of Use Tax, penalty, and interest on the purchase of various trucks, trailers, and replacement parts for those vehicles. The taxpayer asserts that the purchases are exempt from Use Tax based upon the "rolling stock" exemption as set forth in §3-55 and 3-60 of the UTA (35 **ILCS** 105/3-55 and 35 **ILCS** 105/3-60). Those statutory provisions state as follows:

> §3-55. Multistate exemption. To prevent actual or likely multistate taxation, the tax imposed by this Act does not apply to the use of tangible personal property in this state under the following circumstances:
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> (b) The Use, in this State, of tangible personal property by an interstate carrier for hire as rolling stock moving in interstate commerce...
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> § 3-60. Rolling stock exemption. The rolling stock exemption applies to rolling stock used by an interstate carrier for hire, even just between points in Illinois, if the rolling stock transports, for hire, persons whose journeys or property whose shipments originate or terminate outside Illinois.

In order to qualify for exemption from Use Tax or Retailers' Occupation Tax, case law is clear that the burden is always on the taxpayer to show that it is entitled to the exemption. Statutes that exempt property, a transaction, or an entity from taxation must be strictly construed in favor of taxation and against exemption. Wyndemere Retirement Community v. Department of Revenue, 274 Ill.App.3d 455 (2nd Dist. 1995)

In order to qualify for the rolling stock exemption, the claimant must fulfill three distinct requirements. First, to be considered an interstate carrier for hire, the taxpayer must either possess an Interstate Commerce Commission Certificate of Authority, an Illinois Commerce Commission Certificate of Authority, or certify that it is a type of interstate carrier for-hire that in not required by law to have an Illinois Commerce Commission Certificate of Authority. (86 Admin. Code ch. I, Sect 130.340(f)). XYZ produced its certificates of authority to show that this requirement was fulfilled. All of XYZ's movements are conducted pursuant to its interstate authority (Taxpayer Ex. No. 5), exempt authority (Taxpayer's Ex. No. 6), or its intrastate authority (Taxpayer's Ex. No. 19). Throughout the entire audit periods, the Illinois Commerce Commission or the Interstate Commerce Commission regulated XYZ.

The second requirement needed to qualify for the exemption is that the interstate carrier must be "*for-hire*" when providing transportation services. XYZ argues that when it transports materials for Concrete and other customers, that the carriage is for-hire even though the invoices and other documentation show XYZ as the product purchaser.

John Doe, the program director of the review and examination program of the Transportation Division[4] of the Illinois Commerce Commission appeared on behalf of the taxpayer. He testified that in his opinion "the fact that the hauler placed the order in its own name and was billed for the product would not remove it from the realm of for-hire carriage." (Tr. p. 357) The witness went on to state "[T]he way the billing is done would not be a determining factor as to whether or not the transportation is for-hire. If mere billing for a

[4] Mr. Doe is an attorney with that division. (Tr. pp. 350-352)

product or taking the product in your own name would remove commerce from being a for-hire move to a private move, it would create a giant loophole and basically, would destroy any reason for regulation of the move because anyone could then avoid the law by merely purchasing the commodity in their name." (Tr. p. 358) "If it is private carriage, no operating authority would be required." (Tr. p. 366).

Mr. Doe also testified regarding a question published in the Transportation Register, Staff Advisory section which deal with buy-sell arrangements. The situation given was that a trucker goes to a quarry and picks up rock and gravel pursuant to a request of its customer, takes the load to the customer's business and delivers it without either stockpiling, spreading, or grading it. The transportation of rock and gravel is subject to commerce commission jurisdiction[5].

Based upon the basic statutory principle that all sales at retail of tangible personal property are taxable unless exempt by a specific statutory provision which is strictly construed, Follett's Illinois Book & Supply Store, Inc. v. Isaacs, 27 Ill.2d 600 (1963), Wyndemere Retirement Community v. Department of Revenue, 274 Ill.App.3d 455 (2nd Dist. 1995), for the exemption at issue, the pertinent statute and regulation look to type and frequency of movement for that specific piece of equipment. On the other hand, the Commerce Commission concerns itself with vehicle movement in a general sense. That is, an entity is regulated by the commission if it uses any of its equipment for interstate carriage at any time.

The Department concedes that XYZ uses some of its equipment for interstate for-hire carriage. However, the tax exemption at issue applies to specific pieces of equipment, and therefore, the analysis must be a specific one, testing particular equipment movement. Although Mr. Doe's competency in his area is not questioned, his opinions as they relate to the Use Tax Act have no weight because the focus of the Illinois Commerce Commission is totally different than the focus of the Department when looking at the equipment at issue. The bottom line is that the Illinois Commerce Commission is concerned with regulation of carriers for-hire. It is

[5] Tr. pp. 359-360

irrelevant to the commerce commission how often an entity acts in that capacity; rather, they are concerned with the entity itself and whether the movement by that entity is interstate or intrastate for-hire. The Department, on the other hand, is concerned with the taxation of the equipment itself. On cross-examination, Mr. Doe acknowledged that the application of the rolling stock exemption for the Illinois Sales Tax was not within his purview. (Tr. p. 367)[6]

While the type of carriage at issue would not be exempt from the Department of Commerce jurisdiction, it also is clearly not exempt from taxation either. The State Transportation Policy is to actively supervise and regulate commercial transportation of persons and property within this state. 625 **ILCS** 5/18c-1103. That is totally different than the imposition of taxes upon the privilege of using in this State tangible personal property purchased at retail from a retailer... 35 **ILCS** 105/3. Further, the fact that the taxpayer has interstate carrier registration is not dispositive of the issue of whether it is, as a matter of fact, an interstate carrier for-hire qualifying for the pertinent tax exemption. This registration, alone, does not evince how taxpayer actually uses the equipment at issue. First Nat'l Leasing & Fin. Corp. v. Zagel, 80 Ill. App. 3d 358 (4th Dist. 1980)

Since the focus and impact of the Department of Commerce and the Department of Revenue are so different, my analysis of this specific tax exemption must center on the pertinent revenue statutes and the corresponding regulations. Those regulations provide, in part, that the exemption does not apply if the interstate travel is for the purpose of carrying the carrier's own property. 86 Admin. Code ch. I, §150.310

The bills of lading reflect that XYZ was the purchaser of the product. The invoices were billed to XYZ and XYZ paid for the product. There is no invoicing from XYZ to Concrete, rather bookkeeping entries reflect those sales. XYZ does not deny that it paid for the materials. As much as XYZ tries to identify itself as simply a hauling company, this assertion is belied by

[6] Similarly, Ronald L. Riggle, a transportation consultant and president of Mack and Riggle, Inc., appeared as a witness for the taxpayer. He agreed with Mr. Doe's characterization of the trips done by XYZ for Concrete, that they would be "for-hire" for transportation and Commerce Commission purposes. Likewise, on cross-examination he admitted that he had no expertise with regard to Illinois sales tax. (Tr. pp. 386-388)

the plain reading of its invoices and documents that show that not only did it purchase and pay for the materials in its own name, it did so with its own business funds. Prior to XYZ changing its method of operations in 1997, there was no separation of the charges for the materials and the hauling and no invoices reflect carriage by XYZ for Concrete or other customers.

In addition, XYZ actually admitted that its trucks were moving its own product prior to 1997. Jane Doe, the Vice-President and office manager of XYZ and also of Concrete, testified that "A similar movement (occurred) where Joe Blow, the driver of Unit Number 00 left Nashville going to St. Louis, Missouri, picked up a load of bulk cement from XYZ vendor, Cement and brought it back to Anywhere, Illinois. " (Tr. p. 281) Ms. Doe was testifying regarding the list that the taxpayer prepared of the interstate trips taken during the audit periods and submitted as Taxpayer's Ex. No. 9 to support its position that it moved property for-hire in interstate commerce during the audit period. Taxpayer's Ex. Nos. 9 through 16 are lists prepared by the taxpayer of trips taken, destinations, dates, bills of lading numbers, and drivers. Sample bills of lading dated prior to 1997 and submitted by the taxpayer, show that XYZ is the entity that the gravel was sold to. *See* Taxpayer's Ex. No. 17.

XYZ's invoices and bills of lading show that the products were sold to XYZ. The writing on those documents states: "sold to" followed by the name "XYZ." (Taxpayer's Ex. Nos. 2, 17) I find that XYZ was not acting in a "for-hire" capacity when it was hauling materials that were sold to it.

Also, it is noteworthy that three of the trucks purchased by XYZ for which it asserted the rolling stock exemption were rock spreaders. Two were Agricat spreaders and one was a super stone spreader. Based upon the function of this equipment, it is reasonable to conclude that this type of machinery does not qualify for exemption as rolling stock as it is used spread the product bought by XYZ. Certainly, the taxpayer did not present any evidence to the contrary.

The Illinois Appellate Court has addressed a situation factually similar to the one between XYZ and Concrete and XYZ's other customers. The court determined that a rock hauler who paid the quarry for rock and then billed its customer a single charge for both the hauling and

product was a retailer and subject to sales tax on his retail sales of rock. Sprague v. Johnson, 195 Ill.App.3d 798 (4th Dist. 1990) Applying Sprague, XYZ was hauling its own materials when the documents listed XYZ as the purchaser of the materials and XYZ paid the supplier for those materials. The only difference in the case at issue and Sprague is that XYZ was not responsible for the sales tax on the materials sold to Concrete and its other customers because, as determined by the Department, those were sales for resale. Sprague was decided by the Appellate Court on March 30, 1990. The taxpayer certainly could or should have known of the decision prior to the audit in question, especially as they are in the same business as Sprague.

In order to qualify for the rolling stock exemption, the third requirement states that the taxpayer must prove by documentary evidence that it transports persons or property for-hire *moving in interstate commerce.* In the case of First National Leasing & Financial Corporation v. Zagel, 80 Ill.App.3d 358 (4th Dist. 1980) the court said that oral testimony concerning the taxpayer's interstate activities was not sufficient to prove its claim to the rolling stock exemption. XYZ failed to establish which trucks drove which trailers. XYZ also failed to establish which repair parts were used on specific trucks or trailers. XYZ did not have sufficient records to show that the majority of its trucks and trailers operated in interstate commerce for-hire on a regular and frequent basis or in the alternative at least 15 times in a 12-month period. It is basic Illinois tax law that a taxpayer's oral testimony, without corroborative evidence, is insufficient to rebut the Department's *prima facie* case. Once the Department establishes a *prima facie* case of correctness of amount of tax due, the burden shifts to the taxpayer to produce competent evidence, identified with books and records showing that the Department's records are incorrect. It was in the taxpayer's best interest to maintain detailed records that clearly indicate the character and cost price of every transaction as required under section 140.701 of the Illinois Administrative Code. 86 Admin. Code ch I, Sec. 140.701. A.R. Barnes & Co. v. Department of Revenue, 173 Ill.App.3d 826 (1st Dist. 1988)

As detailed in the administrative rules, "[t]he term 'rolling stock' includes the transportation vehicles of any kind of interstate transportation company for-hire but not vehicles

which are being used by a person to transport its officers, employees, customers or others for-hire (even if they cross State lines) or to transport property which such person owns or is selling and delivering to its customers (even if such transportation crosses State lines). 86 Admin. Code ch. I, Sec. 130.430(b). *See also* 86 Admin. Code ch. I Sec. 150.310

The use of rolling stock definition for the tax acts was amended by Public Act 91-587 effective August 14, 1999. The amendment added additional language to state:

> Use as rolling stock definition. "Use as rolling stock moving in interstate commerce" in (various) subsections (of the tax acts) . . . means for motor vehicles, as defined in Section 1-146 of the Illinois Vehicle Code, and trailers, as defined in Section 1-209 of the Illinois Vehicle Code, when on 15 or more occasions in a 12-month period the motor vehicle and trailer has carried persons or property for hire in interstate commerce, even just between points in Illinois, if the motor vehicle and trailer transports persons whose journeys or property whose shipments originate or terminate outside Illinois. This definition applies to all property purchased for the purpose of being attached to those motor vehicles or trailers as a part thereof.[7]

86 Admin. Code ch. I §150.310 was amended to conform to the statutory change. Sub-section (e) was re-lettered and new language was added on July 7, 2000, which states:

> e) Pursuant to Public Act 91-0587, motor vehicles . . . and all property purchased for the purpose of being attached to those motor vehicles . . . will qualify as rolling stock under this Section if they carry persons or property for hire in interstate commerce on 15 or more occasions in a 12-month period. [35 **ILCS** 120/2-51] The first 12-month qualifying period for the use of a vehicle or trailer begins on the date of registration or titling with an agency of this State, whichever occurs later. . . . The vehicle or trailer must continue to be used in a qualifying manner for each consecutive 12-month period. The Department will apply the provisions of this subsection in determining whether such items qualify for exempt status under this Section for all periods in which liability has not become final or for which the statute of limitations for filing a claim has not expired. A liability does not become final until the liability is no longer open to protest, hearing, judicial review, or any other proceeding or action, either before the Department or in any court of this State.
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> 1) If a vehicle or trailer carries persons or property for hire in interstate commerce on 15 or more occasions in the first 12-month period or in a subsequent 12-month period-but then does not carry persons or property for hire in interstate commerce on 15 or more occasions in a subsequent 12-month period, the vehicle, . . . will be

[7] 35 **ILCS** 105/3-61; 35 **ILCS** 110/3-51; 35 **ILCS** 115/2d; 35 **ILCS** 120/2-51.

subject to tax on its original purchase price even if it was then used in a qualifying manner in the third 12-month period.

2) For repair or replacement parts to qualify for the rolling stock exemption, the vehicle or trailer upon which those parts are installed must be used in a qualifying manner for the 12-month period in which the purchase of the repair or replacement parts occurred and each consecutive 12 month period thereafter…

XYZ provided no documents as to the trailers and their use with specific trucks; nor did they provide books and records for each purchase to show that it qualified for exemption. In order to qualify for the exemption, a taxpayer must identify the subject purchase and show that there is a specific qualifying use for that specific purchase. XYZ has not done that. The trailers at issue are not permanently attached to the trucks, rather a trailer may be attached at any time; therefore, the use of the trailer in interstate commerce may be incidental and the trailer not qualify for the rolling stock exemption.

XYZ provided no books and records for the trailers to show that they in fact qualified for the rolling stock exemption under the 15-trip per 12-month standard. While the taxpayer complains that the Department analyzed days rather than trips, and miles rather than trips, the taxpayer failed to document the trips or provide evidence of those trips. Because of the lack of books and records substantiating the trips, the auditor used the best information available for his analysis. The second auditor took into account the number of trucks that qualified and reduced the repair parts and trailers by that percentage. Once again, because the taxpayer failed to provide the necessary books and records as required by the statutes, case law, and regulations, the taxpayer again fails to establish that it had sufficient for-hire interstate activity to qualify for the exemption.

The taxpayer asserts that more than one trip hauling grain occurred on several occasions and the auditor did not give it credit for the additional trips that occurred on the same day. However, the first auditor testified that if there was more than one movement per day, and the

taxpayer had evidence of the repetitive travels, he gave the taxpayer credit for the additional trips.[8]

The taxpayer also complains that the second auditor was remiss in discounting the trips that were for the transportation of grain. However, the taxpayer never submitted documentation regarding those trips. Again, because of the lack of evidence, taxpayer fails to substantiate that those trips were ever taken.

The taxpayer also asserts that the Department never notified it in writing that if the invoices had listed Concrete or another customer as the purchaser, the transactions might have been exempt. There was no evidence submitted that the taxpayer ever requested any written informational ruling, opinion, or letter regarding its method of doing business. *See* 20 **ILCS** 2515/3. This argument has no substance.

XYZ also argues that the regular and frequent standard used by the Department is confusing, not quantitative, vague, ill defined, and flawed. Jim Doe, the former general manager of the Illinois Intrastate Bureau, appeared in behalf of the taxpayer and testified that in his opinion the movements of XYZ that started in Missouri and were destined to terminate in Illinois were interstate movements. He said that the trucking associations had a meeting with the Department in either 1994 or 1995 to discuss what the terms "regular" and "frequent" meant in the context of the trucking business. The entities were not successful in coming up with a definite number that would fit "regular" and "frequent" trips. (Tr. pp. 375-376)

While the taxpayer is correct that the terms regular and frequent were not defined by the number of trips by the Department or legislature prior to 1997, the Appellate Court in Nat'l Sch. Bus Service v. Dep't. of Rev., 302 Ill.App.3d 820 (1st Dist. 1998) held that a bus company that failed to show that its use of rolling stock in interstate commerce was more than incidental was not entitled to the rolling stock exemption. In upholding the Department's interpretation regarding the use of the regular and frequent standard, the court stated:

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[8] Tr. pp. 65-67

> The Department has required regular and frequent use in interstate commerce for the exemption. "[N]ot all statements of agency policy must be announced by means of published rules. When an administrative agency interprets statutory language as it applies to a particular set of facts, adjudicated cases are a proper alternative method of announcing agency policies." *Sparks and Wiewel Construction Co. v. Martin,* 250 Ill.App.3d 955 (1993). In this case, as in *Sparks and Wiewel*, the Department interpreted the statute and applied it to the facts. It did not violate the Administrative Procedure Act. *Id.* at 825.

A taxpayer is free to organize his affairs as he chooses, but once having done so, he must accept the tax consequences of his choice, whether contemplated or not and he may not enjoy the benefit of some other route he might have chosen to follow but did not. Commissioner v. National Alfalfa Dehydrating, 417 U.S. 134, 148-49 (1974) *citing* Higgins v. Smith, 380 U.S. 473, 477 (1940). *See also* Rockwood Holding Company v. Department of Revenue, 312 Ill.App.3d 1120 (1st Dist. March 24, 2000). XYZ argues that prior to 1997 all they needed to do was change their method of invoicing from showing XYZ as the purchaser to listing another company in that capacity. I can give no credence to this argument because to accept it means that XYZ does not keep books and records that reflect its operations. Thus, the credibility of all its records is suspect with the result being that XYZ can be given no exemption for any of its equipment. To make the taxability of the transaction dependent upon the determination of whether there existed an alternative form which the statute did not tax would create burden and uncertainty. Commissioner v. National Alfalfa, *supra* quoting Founders General Corp. v. Hoey 300 U.S. 268, 275 (1937) The law does not permit the State to re-characterize the nature of a transaction pursuant to the testimony of the taxpayer which is in direct conflict with the taxpayer's books and records.

Lastly, the taxpayer argues that for the first audit, the Department should not be able to go back six years to assess taxes on repair parts. The Department determined that, although taxes were not paid on these purchases, the retailers that sold the trucks and trailers in question filed returns for those sales with the Department, reporting their Retailers' Occupation Tax liability. Therefore the statute of limitations for those sales is three years for ROTA purposes. 35 **ILCS** 120/4. However, although XYZ owed the Use Tax on its purchases, it was not

registered with the Department for those use taxes due on its purchases of tangible personal property and did not file returns for those acquisitions, claiming exemption. The UTA at 35 **ILCS** 105/12 addresses the time limits on the failure to file a return. The act states

> . . . in the case of a failure to file a return required by this Act, no notice of tax liability shall be issued on and after each July 1 and January 1 covering tax due with that return during any month or period more than 6 years before that July 1 or January 1, respectively . . .

Pursuant to the statute, the Department properly imposed the 6-year statute of limitations on XYZ's purchase of repair parts for the trucks and trailers at issue, based upon XYZ's own use tax liability. Miller Brewing Co. v. Korshak, 35 Ill. 2d. 86 ((1966) a*ppeal dismissed* 386 U.S. 684 (1967))

The Department determined that six additional trucks qualify for the rolling stock exemption pursuant to the 15-trip per 12-month standard. The trucks were all involved in the first audit period of XYZ and the limited scope audit of ABC's Bank. The second auditor gave a percentage reduction of the taxes due for trailers and repair parts based upon the trucks that qualified in the second audit under the regular and frequent standard. Since six additional trucks were found to be exempt by the Department pursuant to the 15-trip 12-month standard as stated in its memoranda, the liability of XYZ must be revised to reflect those additional exemptions. A corresponding percentage must be deducted from XYZ's liability for the repair parts and trailers. XYZ is entitled to a percentage reduction of the tax on the trailers and repair parts in the second audit where the truck parts are unknown. In addition, XYZ is entitled to a reduction of the taxes on repair parts where the truck numbers are known and exempt. It is noted that those six exempt trucks were still part of XYZ's fleet during the second audit. This reduction reduces XYZ's tax liability for the first audit as well as the second audit.

The brief of the taxpayer also asserts that it is inequitable and unfair to assess the taxes, interest, and penalties against the taxpayers. Any authority for an abatement of taxes, interest,

and penalties in an administrative hearing before the Department of Revenue comes from the statutes. There is no abatement of tax and interest provision for equity or fairness.

Regarding an abatement of the penalties at issue, the Uniform Penalty and Interest Act allows for an abatement of penalties if reasonable cause exists. 35 **ILCS** 735/3-8. The statute states:

> The penalties imposed under the provisions of Sections 3-3[9], 3-4[10], and 3-5[11] of this Act shall not apply if the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause. Reasonable cause shall by determined in each situation in accordance with rules and regulations promulgated by the Department.

Pursuant to the authority granted by the legislature, the Department has promulgated rules interpreting reasonable cause at 86 Admin. Code ch I, Sec. 700.400. It states in pertinent part:

* * *

> b) The determination of whether a taxpayer acted with reasonable cause shall be made on a case by case basis taking into account all pertinent facts and circumstances. The most important factor to be considered in making a determination to abate a penalty will be the extent to which the taxpayer made a good faith effort to determine his proper tax liability and to file and pay his proper liability in a timely fashion.
>
> c) A taxpayer will be considered to have made a good faith effort to determine and file and pay his proper tax liability if he exercised ordinary business care and prudence in doing so. A determination of whether a taxpayer exercised ordinary business care and prudence is dependent upon the clarity of the law or its interpretation and the taxpayer's experience, knowledge, and education. Accordingly, reliance on the advice of a professional does not necessarily establish that a taxpayer exercised ordinary business care and prudence, nor does reliance on incorrect facts such as an erroneous information return.
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> * * *

[9] 35 **ILCS** 735/3-3, Penalty for failure to file or pay.
[10] 35 **ILCS** 735/3-4, Penalty for failure to file correct information returns.
[11] 35 **ILCS** 735/3-5, Penalty for negligence.

There was no set standard for the number of trips necessary to qualify equipment for the rolling stock exemption prior to 1999. The Department in fact exempted additional trucks after the hearing in this matter was concluded, because Public Act 91-587 had been made into law and a definitive number of trips taken as rolling stock used for hire as interstate commerce has been established by the legislature. Based upon all these factors, I find there is reasonable cause to abate the penalties at issue.

For the foregoing reasons it is recommended that this matter be resolved partly in favor of the Department of Revenue, with adjustments made for the trucks found to be exempt based upon the 15-trips per 12-month standard and the related trailers and repair parts for those trucks. It is also recommended that this matter be resolved partly in favor of XYZ, with adjustments made for the trucks that qualify based upon the 15-trips per 12-month standard and the trailers and repair parts affiliated with those trucks. It is also recommended that the penalties be abated. It is recommended that the liability of ABC BANK be upheld with a tax adjustment for the three trucks determined to be exempt under the 15-trips per 12-month standard. It is also recommended that the penalties be abated.

Respectfully Submitted:

Date: July 16, 2001

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Barbara S. Rowe
Administrative Law Judge